

MINUTES OF THE REGULAR MEETING OF THE ARIZONA STATE RETIREMENT SYSTEM BOARD

**HELD ON
February 20, 2004
8:30 a.m., MST**

The Arizona State Retirement System (ASRS) Board met in the 10th Floor Board Room, 3300 N. Central Avenue, Phoenix, Arizona. Mr. Karl Polen, Chairperson, Arizona State Retirement System Board, called the meeting to order at 8:35 a.m., MST.

The meeting was teleconferenced to the ASRS office at 7660 E. Broadway, Tucson, Arizona 85710.

1. Call to Order; Roll Call, Opening Remarks

Present: Mr. Karl Polen, Chairperson
Ms. Charlotte Borchert
Mr. Jim Bruner
Dr. Chuck Essigs
Dr. Keith Meredith
Mr. Michael Townsend
Mr. Lawrence Trachtenberg
Mr. Steven Zeman

A quorum was present for the purpose of conducting business.

Absent: Ms. Anne Mariucci

Mr. Norman Miller announced his resignation from the ASRS Board, effective immediately, and recused himself from voting. He stated it was a pleasure working with members of the Board as well as the ASRS staff and added it was time to turn the trusteeship over to his successor, Ms. Anne Mariucci.

Mr. Karl Polen, Board Chairperson, added that it has been a pleasure working with Mr. Miller and acknowledged Mr. Miller's tremendous contribution to the ASRS. Mr. Polen appointed Mr. Jim Bruner as interim Vice Chairperson until the Board can make a permanent appointment. This will be placed on the agenda for the next scheduled meeting of the ASRS Board. Mr. Bruner agreed to act as Vice Chairperson for an interim period.

2. Approval of Minutes of the January 16, 2004 Regular Meeting and the minutes of the January 22, 2004 Special Meeting of the ASRS Board.

Motion: Dr. Keith Meredith moved to approve the minutes of the January 16, 2004 Regular meeting and the minutes of the January 22, 2004 Special meeting of the ASRS Board.

Dr. Chuck Essigs seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, and 1 excused, the motion was approved.

3. Approval of Consent Schedule

Motion: Mr. Jim Bruner moved to approve Refunds, Death Benefits, Retirements, System Transfers, and the Applications and Agreements with:

- Three Points Fire District
- Mountain School, Inc.
- Belle Affeld Beloved Humanities Academy dba Humanistic Education Authentic Rigorous Transcendent
- Kids at Hope Academy, Inc.

And

Move to approve the notice of final rulemaking regarding new Article 2, State Retirement Defined Contribution Program.

And

Move for approval to proceed with the process of hiring for the position of Assistant Director, Member Services Division.

Mr. Steven Zeman seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, and 1 excused, the motion was approved.

Mr. Karl Polen, Chairperson, deferred agenda items #4 and #5 to later on the meeting agenda.

6. Presentation, Discussion and Appropriate Action Regarding the ASRS' Fixed Income Passive Asset Allocation

Mr. Jim Burner, Chairperson, Investment Review Committee (IRC), explained that the IRC has spent a considerable amount of time reviewing different aspects of the allocation process. As a result, the IRC has developed a revised fixed income passive asset allocation with a recommendation for the ASRS Board.

Motion: Mr. Jim Bruner moved to approve the Fixed Income Passive Asset Allocation targets to be revised to 80% +/- 20% from 80% +/- 10% which broadens the passive target band ranges.

Dr. Keith Meredith seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, and 1 excused, the motion was approved.

Anne Mariucci, Board Trustee, arrived at the meeting at 8:46 a.m.

7. Presentation, Discussion and Appropriate Action Regarding the Application of Interest to Service Purchase Payroll Deduction Agreements

Mr. John Hendricks, Project Manager, explained that during the ASRS simplification and equity analysis project, a significant amount of forgone income was identified. The term “forgone income” means that the opportunity to have earned income has passed. This is a result of the Payroll Deduction Agreement (PDA) program for the payment of service purchases. The goal is to eliminate or reduce this forgone income and determine a solution considering both the financial stability of the fund and the benefits of the ASRS members.

Mr. Hendricks identified problems in the PDA program such as the PDAs are interest free loans, there are no administrative fees charged to offset the costs to the ASRS to administer this program, and members have no incentive to complete payment for the service within a reasonable time frame. Estimates of forgone income are illustrated in the following table:

If the maximum length of PDAs were:	Then forgone income would be:
Currently (9,999 payments)	\$62,335,100
10 Years (260 payments)	\$53,729,300
5 Years (130 Payments)	\$40,428,300
2 Years (52 Payments)	\$20,913,700
1 Year (26 Payments)	\$10,940,600

The purpose of the PDA program is to allow members to make payments for their service purchase in installments. However, this is the only type of service payment that results in forgone income.

Ms. Teresa Donohue, Project Manager, explained the different options that were considered and discussed the pros and cons for each option. The first option is to abolish the PDA program. The second option is to charge interest on the PDA balance at the assumed actuarial investment earnings rate. The third option is to charge interest on the PDA balance at current market rates. Finally, the fourth option is to limit PDA payments to one year without interest being charged.

Mr. Hendricks and Ms. Donohue recommended the second option of charging interest on the PDA balance at the assumed actuarial investment earnings rate, currently 8%. Additionally, a limit would be set at 20 years for payment. It was also recommended that the effective date for this change would be April 1, 2004. Requests to purchase service with the ASRS on or after this date shall be charged interest on the PDA payments.

Motion: Dr. Chuck Essigs moved to approve the policy for charging of interest on the principal balance of Payroll Deduction Agreements at the assumed actuarial investment earnings rate.

Mr. Steve Zeman seconded the motion.

By a vote of 9 in favor, 0 opposed, 0 abstentions, and 0 excused, the motion was approved.

8. Presentation, Discussion and Appropriate Action Regarding 2004 Legislation as requested by the External Affairs Review Committee

Ms. Susanne Dobel, Manager, External Affairs, provided an update on the ASRS' 2004 legislation. Ms. Dobel stated three out of four bills have passed out of the House by unanimous vote. The fourth bill, House Bill 2078 pertaining to investment management, is currently being held in House Rules as some adjustments have been requested by Representative Karen Johnson. Representative Johnson's concerns are about increasing the limitation in foreign investments.

House Bill 2666, Retirement; Elected Official and Judges was just introduced. The bill transfers all elected officials into the ASRS plan after January 1, 2005. A meeting will be scheduled with the bill's sponsor to determine the purpose of the bill. There was a strike everything amendment on House Bill 2008, Arizona Rangers Pension, titled Retired members; dependents; health insurance; premium payment; separate account; definitions, that impacts the premium benefit program by clarifying that two ASRS retirees who are married are eligible to receive the greater of two single or one family premium benefit.

Agenda item #11 was moved ahead of items #9 and #10 at the Chairperson's request.

11. Presentation, Discussion and Appropriate Action Regarding the ASRS Director Evaluation

Motion: Mr. Jim Bruner moved to convene to Executive Session at 9:15 a.m.

Dr. Chuck Essigs seconded the motion.

The ASRS Board reconvened to regular session at 9:47 a.m.

The ASRS Board provided a number of positive comments pertaining to Paul Matson's performance as Director. The following paraphrases and comments were made:

- He has done an excellent job and is wise beyond his years.
- Paul has changed the focus of the ASRS and addressed its problems.
- He has provided new Board Trustees with a well-done orientation process. He is a team player.
- He has made a huge difference in staff hiring.
- He is aggressive, but at the same time, he has improved staff moral – excellent.
- Good orientation program.
- Senior staff is on the same page with Paul with regard to goals of the Agency.

- He has done a marvelous job.

Motion: Mr. Jim Bruner moved to recommend a 9% salary increase of which 2% would be a cost of living adjustment and 7% for merit for Mr. Paul Matson, Director.

Dr. Keith Meredith seconded the motion.

Mr. Matson responded by sincerely thanking the trustees for their comments and added that the positive statements are also a reflection of the ASRS staff. He stated, however, that since there is currently not a budget to support pay adjustments for other employees, he will abstain from accepting an increase in his salary until an increase for State employees is awarded. As a result of this abstention, the salary adjustment will be retained in the ASRS trust fund.

Dr. Essigs departed the meeting at 9:49 a.m.

4. Presentation, Discussion and Appropriate Action Regarding the Total Fund Performance Overview for the Period Ending December 31, 2003

Mr. Terry Dennison, Principal, Mercer Investment Consulting, presented an economic and market review and reported on the Total Fund for the period ending December 31, 2003.

	Quarter	1 Year	3 Years	5 Years	Inception
Total Fund	10.0%	24.9%	1.1%	3.5%	11.0%
Benchmark*	9.5	22.9	0.2	2.0	9.3
RM Public Funds Median	9.3	24.3	2.2	4.8	
Percentile Ranking	15	34	82	87	

*Interim Benchmark of 56% S&P 500/28% LB Aggregate/16% EAFE, which incorporates a proration of 6% real estate.

1/1/89-12/31/91 is 60% S&P 500/40% LB Aggregate,

1/1/92-12/31/94 is 50% S&P 500/40% LB Aggregate/10% EAFE,

1/1/95-6/30/97 is 45% S&P 500/40% LB Aggregate/15% EAFE,

7/1/97-12/31/99 is 50% S&P 500/35% LB Aggregate/15% EAFE,

1/1/00-09/30/03 is 53% S&P 500/30% LB Aggregate/17% EAFE,

10/1/03-Present is 53% S&P 500/26% LB Aggregate/15% EAFE/6% Real Estate (Benchmark TBD)

5. Presentation, Discussion and Appropriate Action Regarding the Performance of Domestic Small Cap Equity Managers for the Period Ending December 31, 2004

Mr. Seth Lynn, Chairman, presented for Byram Capital Management.

Absolute and Relative Performance:

	Q403	1 Year	3 Years	5 Years	Inception*
ASRS	16.0	46.9	20.3	18.5	19.4
Russell 2000	14.5	47.3	6.3	7.1	11.3
Relative Return	1.5	-0.4	14.0	11.4	8.1

* 8/31/98

Mr. Richard Johnson, CFA, Senior Vice President and Chief Investment Officer, and Mr. Peter Hendricks, Senior Vice President presented for Columbia Management.

Absolute and Relative Performance:

	Q403	1 Year	Inception*
ASRS	12.4	44.7	3.6
Russell 2000	12.7	48.5	1.8
Relative Return	-0.3	-3.8	1.8

* 01/02/02

Mr. Steve Clark, Portfolio Manager, presented for Dimensional Fund Advisors.

Absolute and Relative Performance:

	Q403	1 Year	3 Years	5 Years	Inception*
ASRS	20.9	56.0	15.7	14.7	16.9
Russell 2000	16.4	46.0	13.8	12.3	14.5
Relative Return	4.5	10.0	1.9	2.4	2.4

* 8/31/98

Mr. Karl Polen departed the meeting at 11:15 a.m.

Mr. Richard Forster, Managing Director, Marketing, and Ms. Susan Ellison, CFA, Managing Director, Equity Portfolio Management presented for Mellon Capital Management.

Absolute and Relative Performance:

	Q403	1 Year	3 Years	5 Years	Inception*
ASRS	14.6	47.5	7.01	7.9	12.0
Russell 2000	14.5	47.3	6.3	7.1	11.3
Relative Return	0.1	0.2	0.8	0.8	0.8

* 8/31/98

9. Director's Report.

Mr. Matson had no further comments to add regarding the Director's Report.

10. Brief Summary of Current Events

This item was covered earlier in the meeting.

12. Board Requests for Agenda Items

None.

13. Call to the Public

None.

14. The next ASRS Board meeting is scheduled for Friday, March 19, 2004, at 9:30 a.m., at 7660 E. Broadway Boulevard, Suite 108, Tucson, Arizona.

15. Adjournment of the ASRS Board

Mr. Jim Bruner, Acting Vice-Chairperson, adjourned the February 20, 2004, meeting of the ASRS Board at 11:33 a.m.

ARIZONA STATE RETIREMENT SYSTEM

Marina Chaves, Secretary

Date

Paul Matson, Director

Date